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### Commonhold reform

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# Commonhold Reform: A Scottish Perspective

## A. INTRODUCTION

Feudal abolition<sup>1</sup> on 28 November 2004 is now receding into history. Yet in terms of the scale of its effect on Scottish land law, it came immediately to mind when I read of the Law Commission for England and Wales' recommendations for *The Future of Home Ownership*.<sup>2</sup> These are contained in three separate but linked reports which in total run to nearly 2000 pages. They are:

- *Leasehold home ownership: buying your freehold or extending your lease* (Law Com No 392, 2020)
- *Leasehold home ownership: exercising the right to manage* (Law Com No 393, 2020)
- *Reinvigorating commonhold: the alternative to leasehold ownership* (Law Com No 394, 2020).<sup>3</sup>

On reading these titles, a Scottish property lawyer is likely to have a sharp intake of breath at the idea that a lessee can be said to have ownership. The glossaries to the three reports, however, explain that “freehold” is a “form of property ownership that lasts forever”. In contrast, “leasehold” is a “form of property ownership which is time-limited (for example, ownership of a 99-year lease)”.<sup>4</sup> Thus, all is well again,<sup>5</sup> for it is the lease that is “owned” and not the physical building.

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<sup>1</sup> By virtue of the Abolition of Feudal Tenure etc (Scotland) Act 2000.

<sup>2</sup> See too Report on *Re-invigorating commonhold: the alternative to leasehold ownership* (Law Com No 394, 2020) para 1.24.

<sup>3</sup> For an overview, see N Hopkins and C McKearney, “The future of home ownership: the Law Commission’s recommendations on enfranchisement, commonhold and the right to manage” (2020) 24 *Landlord and Tenant Review* 173.

<sup>4</sup> The terminology is occasionally used in Scotland. When Malcolm Rifkind QC, then Conservative Foreign Secretary, lost his Edinburgh Pentlands seat to Lynda Clark QC (as she then was) in the 1997 general election he said that the Labour party now had the seat on leasehold rather than freehold. The successor seat is now held by Joanna Cherry QC. If anything, the Faculty of Advocates can claim the “freehold” as that part of Edinburgh has been held continuously by one of its members since 1964.

<sup>5</sup> But not if the view is taken that incorporeal property cannot be owned. See G L Gretton, “Ownership and its objects” (2007) 71 *Rabel’s Zeitschrift* 802.

The fact that many homes in England and Wales are held on leasehold has long been controversial. There are two principal reasons: first, it is time limited and secondly, control of the property is shared with the landlord. The latter feature has a resonance again with the feudal system. For property developers, leasehold is attractive because of future rental income.

High-level policy decisions in relation to home ownership must be left to politicians. Thus, the UK Government has already committed to banning the sale of houses on a leasehold basis.<sup>6</sup> For flats, however, there are big decisions still to be taken. Flats are the focus of the rest of this note. Here, as we shall see, reform of commonhold has particular significance. In Scotland, there may be lessons to learn. Our law of flats was substantially reformed (just as the feudal system was abolished) on 28 November 2004 by the Tenements (Scotland) Act 2004. Sixteen years on there are increasing calls for further legislative action in a country where flats account for 24% of the housing stock.<sup>7</sup>

## B. CURRENT LAW

In England and Wales, flats are typically held on leasehold tenure. The principal reason for this is a major fault line between land law north and south of the border. In freehold tenure, English law is unwilling to accept positive obligations, such as a duty to maintain or to pay a share of maintenance, which bind successor owners.<sup>8</sup> As the Law Commission notes, such “obligations are especially important for the effective management of blocks of flats”.<sup>9</sup> In Scotland, however, this is possible by means of a real burden.<sup>10</sup> In addition there are default positive obligations of support and shelter under tenement law.<sup>11</sup>

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<sup>6</sup> *Ibid* para 1.63.

<sup>7</sup> Amounting to 584,000 properties. See *Working Group on Tenement Scheme Property: Final Recommendations Report* (2019) available at <https://www.befs.org.uk/wp-content/uploads/2019/06/Working-Group-on-Maintenance-of-Tenement-Scheme-Property-Final-Recommendations-Report.pdf> at 12.

<sup>8</sup> The leading modern case is *Rhone v Stephens* [1994] 2 AC 310. English land law is not alone in being uncomfortable with positive obligations in property law. For a recent comparative discussion, see S Demeyere “Contractual Regulation of Property Rights: Opportunities for Sustainability and Environmental Protection” in S Demeyere and V Sagaert (eds), *Contract and Property with an Environmental Perspective* (2020) 47 at 59-68.

<sup>9</sup> *Re-invigorating commonhold* (n 2) para 1.20.

<sup>10</sup> Title Conditions (Scotland) Act 2003 s 2(1)(a). This is declaratory of the common law.

<sup>11</sup> Tenements (Scotland) Act 2004 ss 7 to 10. Again, this is declaratory of the common law.

To address this deficiency in English law, a new form of land tenure known as commonhold was introduced by the Commonhold and Leasehold Reform Act 2002. Under it the flats in a building are individually owned, but the shared areas are owned and managed by a company run by the flat owners, known as the commonhold association. The day to day management in practice is contracted out to agents, in a similar way that factoring is common in Scotland. The principal advantages of commonhold are that the ownership is perpetual and there is no landlord to whom rent is due.

In practice, however, commonhold has been a failure. Research published in 2015 found that fewer than twenty had been established.<sup>12</sup> Various reasons for this are suggested, including (1) shortcomings in current commonhold law; (2) mortgage providers being unwilling to lend on commonhold units; (3) lack of awareness of this form of ownership; (4) inertia among developers; and (5) leasehold remaining financially advantageous to developers because of future rental income.<sup>13</sup> It is the last of these which the Law Commission considers is the most powerful<sup>14</sup>

## **C: PROPOSED REFORMS**

The recommendations made by the Law Commission are at two levels: (1) overarching policy choices for the UK Government; and (2) technical improvements to the law. In relation to the former, two alternatives are set out.<sup>15</sup> The first is to ban new leaseholds for flats. Commonhold would become obligatory. Existing tenants would be assisted by recommendations in Part II of the report on conversion into commonhold.<sup>16</sup> The second option would leave developers a choice of commonhold and leasehold for flats, but the UK Government would have to decide the extent (if any) to which commonhold should be incentivised and leasehold disincentivised. In addition, it would require to determine what measures it would implement to remove barriers in practice to commonhold such as lack of awareness and inertia.

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<sup>12</sup> See L Xu, “Commonhold Developments in Practice” in W Barr (ed), *Modern Studies in Property Law: Volume 8* (2015) 332.

<sup>13</sup> *Re-invigorating commonhold* (n 2) para 1.38.

<sup>14</sup> *Ibid* para 1.81.

<sup>15</sup> *Ibid* para 1.85.

<sup>16</sup> The report refers here to the Long Leases (Scotland) Act 2012.

The technical improvements to commonhold which the Law Commission goes on to recommend in the remainder of the report are lengthy. Only the briefest of coverage can be given here. Part III deals with new commonhold developments. It has proposals allowing these to be divided into sections, with different management and maintenance regimes for each.<sup>17</sup> This might be used where there are commercial and residential units. In addition, developers are given new powers to retain certain development rights, notwithstanding the fact that the commonhold association has become the owner of the common parts.<sup>18</sup> Part IV looks at the commonhold community. It deals with the commonhold community statement, which sets out the rights and obligations of the owners and of the commonhold association.<sup>19</sup>

Part V is on managing and financing the commonhold. There are recommendations on how to keep the commonhold association running if no flat owner is willing to serve as a director. In such circumstances there is to be a procedure for the appointment of professional directors.<sup>20</sup> Under current commonhold law it is not clear whether the association can take out a block insurance policy to cover an entire building. The report recommends that this should be allowed.<sup>21</sup> Any unit owner would be entitled to see a copy of the policy.<sup>22</sup> There are further recommendations in relation to the association's duty to maintain the common parts adequately.<sup>23</sup> This is to extend to replacement when repair is not possible or economical.<sup>24</sup> It will also be possible for higher standards of repair to be imposed in the commonhold community statement.<sup>25</sup> Under the current law, the directors of the association do not require majority approval for the annual budget. It is recommended that in future that a vote should be required.<sup>26</sup> There should also be a right to challenge the share of expenditure allocated to any unit on the basis that this is not "reasonably proportionate".<sup>27</sup> Significantly, it is recommended that all commonhold associations must have reserve funds which can be

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<sup>17</sup> *Re-invigorating commonhold* (n 2) ch 8.

<sup>18</sup> *Ibid* ch 9.

<sup>19</sup> *Ibid* chs 10 and 11.

<sup>20</sup> *Ibid* para 12.32.

<sup>21</sup> *Ibid* para 12.117.

<sup>22</sup> *Ibid* para 12.126. This would mirror the Tenements (Scotland) Act 2004 s 18(5).

<sup>23</sup> Commonhold and Leasehold Reform Act 2002 s 26(c). See Consultation Paper on *Re-invigorating commonhold: the alternative to leasehold ownership* (Law Com CP No 241, 2018) para 9.106.

<sup>24</sup> *Re-invigorating commonhold* (n 2) para 12.174.

<sup>25</sup> *Ibid* para 12.160.

<sup>26</sup> *Ibid* para 13.29.

<sup>27</sup> *Ibid* para 13.102.

used to meet items of capital expenditure.<sup>28</sup> It is also recommended that the ways in which an association can obtain emergency finance should be clarified, an important issue considering the experience of the Grenfell Tower fire tragedy which necessitated urgent work in many blocks of flats to remove cladding.<sup>29</sup>

Part VI concerns dispute resolution, minority protection and enforcement. It is recommended that there should be procedures to allow disagreements to be resolved more quickly and cheaply, including creating a New Homes Ombudsman.<sup>30</sup> There should also be a minority protection regime under which application could be made to the First-tier Tribunal (Property Chamber) in limited circumstances by owners adversely affected by a majority decision by the members of the association.<sup>31</sup> On enforcement, where unit owners do not pay the contributions due by them, the association would have the right as a last resort to make a court application to have the unit sold to meet these costs.<sup>32</sup>

Finally, Part VII deals with protecting the association from insolvency and striking off, and the procedures for the voluntary termination of commonhold where the building comes to the end of its useful life.

#### **D. THOUGHTS FROM SCOTLAND**

The Law Commission's conclusion that reform of commonhold law on its own will not reinvigorate it is surely correct. More drastic action is needed such as the suggested banning of leasehold for new flats.<sup>33</sup> Feudal abolition in Scotland was mentioned at the start of this note. In 1974, legislation which worked towards that abolition prohibited leases of more than twenty years of any residential property.<sup>34</sup> There is now a general ban on any lease of land exceeding 175 years.<sup>35</sup> Behind these provisions was a policy concern that the feudal system would be replaced by long leasehold. The twenty-year rule, however, has been made subject

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<sup>28</sup> *Ibid* para 14.11

<sup>29</sup> *Ibid* ch 15.

<sup>30</sup> *Ibid* ch 16.

<sup>31</sup> *Ibid* ch 17.

<sup>32</sup> *Ibid* ch 18.

<sup>33</sup> On one view, however, the Law Commission proposals "look like attempts to reinvigorate a corpse": see M J D, "Leaseholds: more reform – perhaps" 2020 Conv 113.

<sup>34</sup> Land Tenure Reform (Scotland) Act 1974 s 8.

<sup>35</sup> Abolition of Feudal Tenure etc (Scotland) Act 2000 s 67.

to an increasing number of exceptions over the years, including the new private residential tenancy, introduced by the Private Housing (Tenancies) (Scotland) Act 2016. This has had to be used since 1 December 2017 for new residential lets.<sup>36</sup> That exception seems to drive a coach and horses through the restriction. As far as I am aware, however, developers have not changed practice because of it.

Our flats legislation, as noted above, is the Tenements (Scotland) Act 2004, which was based on a report of the Scottish Law Commission.<sup>37</sup> Its approach is lighter touch than the commonhold legislation. The existing law on ownership of the different parts of the building was essentially codified. Either these are owned individually or in common by the flat proprietors.<sup>38</sup> There is no incorporated company holding common parts. The 2004 Act introduced the Tenement Management Scheme (TMS) which, in contrast to the prior law, enabled majority decision making.<sup>39</sup> Liability for repairs to common and key parts of the building is normally shared equally by the flat owners.<sup>40</sup> But the 2004 Act is a default law, subject to the terms of the title to the tenement.<sup>41</sup> Somewhat to my surprise, the Scottish legislation does not get a single mention in the Law Commission's report on commonhold.

The Scottish Law Commission report also provided the initial basis for what is now the Development Management Scheme (DMS).<sup>42</sup> This can be applied to developments (which may or may not be single tenements) by the owners. It creates a structure much more like commonhold. There is an owners' association which is a body corporate (but not a company). The shared parts of the development are owned by the association. The development must have a manager and an annual budget requires to be set. Take up of the DMS has been slow, although in recent years has increased. Given the need for unanimity among owners to impose it, in practice it is only done by developers for new developments.

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<sup>36</sup> 1974 Act s 8(3ZA).

<sup>37</sup> Report on *The Law of the Tenement* (Scot Law Com No 162, 1998).

<sup>38</sup> Tenements (Scotland) Act 2004 ss 1 to 3.

<sup>39</sup> 2004 Act Sch 1.

<sup>40</sup> 2004 Act Sch 1 rule 4.

<sup>41</sup> 2004 Act s 4.

<sup>42</sup> Title Conditions (Scotland) Act 2003 Part 6 and the Title Conditions (Scotland) Act 2003 (Development Management Scheme) Order 2009, SI 2009/729.

While the 2004 Act is a significant improvement from the prior law, there is growing consensus that further reform is needed to ensure the maintenance of tenements. In 2018 a Scottish Parliament Cross-Party Working Group was established to examine the subject. I was a member. It produced a final report in June 2019.<sup>43</sup> This is at a high level and contains three major recommendations which would be compulsory for flatted buildings: (1) five-yearly inspections; (2) owners' associations; and (3) reserve funds. It called for new legislation by 2025. Let us compare its recommendations with those of the Law Commission.

The first working group recommendation has no parallel in the Report on Commonhold.<sup>44</sup> The second would bring tenement law much closer to commonhold law. But the working group's preferred owners' association model is the Development Management Scheme. This avoids the Companies House reporting required of commonhold associations. The view of the working group was that establishing owners' associations in every tenement<sup>45</sup> would "provide leadership, effective decision-making processes and the ability of groups to enter into contracts".<sup>46</sup> The lighter touch provided by the TMS was felt to be insufficient. But the new approach raises the obvious question of how a functioning owners' association in every tenement can be achieved. Merely legislating for it would not be enough. Here the working group suggests a fallback of compulsory factoring. It was very aware that there are technical challenges in implementing this recommendation. In particular for existing tenements there is the question of how this would relate to the titles. It will be recalled that the TMS is a default scheme. Therefore, the group was of the view that the matter should be referred to the Scottish Law Commission.

The third working group recommendation matches that of the Law Commission because reserve funds are currently not compulsory either north or south of the border. There is clear policy consensus here. Under commonhold the association would hold the fund. In Scotland, matters are not so straightforward in the absence (at least at present) of owners' associations except where the DMS applies. The working group suggests a special national or

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<sup>43</sup> *Final Recommendations Report* (n 8).

<sup>44</sup> I am grateful to Colin Oakley of the Law Commission for drawing my attention to the Fire Safety Bill which is currently before the UK Parliament and the draft Building Safety Bill.

<sup>45</sup> Although the working group discussed a possible exception for very small tenements with only two flats.

<sup>46</sup> *Final Recommendations Report* (n 8) at 6.



regional level fund and gives the example of Safe Deposits Scotland which holds residential tenancy deposits.

The Scottish Government published a response to the recommendations in December 2019.<sup>47</sup> This accepted the need to improve the condition of tenements. It set out ways in which voluntary and incremental change could be supported. These included convening a group of finance professionals to advise on reserve funds, initially on a voluntary basis and commissioning research on the level of expected contribution to such funds. On the principal recommendations, however, the Scottish Government has not just referred the question of owner's associations to the Scottish Law Commission. It has also done this with the inspection and reserve fund recommendations. The response notes that the Commission currently has a full programme of work and that accordingly legislation by 2025 would be "ambitious". Undoubtedly, when the Commission does come to look at what reforms are required, the detailed work of its sister body on commonhold will prove of considerable interest.

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<sup>47</sup> Available at <https://www.gov.scot/publications/tenement-maintenance-report-scottish-government-response/>.